No. 14,953

United States Court of Appeals

For the Ninth Circuit

JOHN O. ENGLAND, Trustee of the Estate of Daniel E. Sanderson, Bankrupt,
Appellant,

vs.

DANIEL E. SANDERSON, Bankrupt,
Appellee.

APPELLANT'S OPENING BRIEF.

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Subject Index

Table of Authorities Cited

Statutes

Texts

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STATEMENT OF JURISDICTION.

The Referee in Bankruptcy on February 10, 1955, made and entered an order setting aside to Appellee a homestead exemption not exceeding the value of $12,500.00, which order was made in the proceeding pending in the United States District Court for the Northern District of California, entitled "In the Matter of Daniel E. Sanderson, Bankrupt," being No. 42844, in the records and files of said court (T.R., p. 17). Appellant's petition to have the order reviewed by the District Court was filed on March 14, 1955 (T.R., p. 63). The Petition was timely (11 USCA Section 67(c)). The District Court had ju-

risdiction to review the order (11 USCA Section 67(c)). In an order made on October 5, 1955, the District Court affirmed the order of the Referee (T.R., p. 66). Notice of appeal therefrom to this court was filed October 24, 1955 (T.R., p. 71). The appeal was timely (11 USCA 48). Jurisdiction of this court to review the order of the District Court is sustained by 11 USCA 47.

STATEMENT OF QUESTION PRESENTED.

The question before the court is as to the allowance to the Appellee Bankrupt of an homestead in certain real property in excess of the sum of $7,500.00.

STATEMENT OF FACTS.

On April 12, 1954 a voluntary petition in bankruptcy was filed by Daniel E. Sanderson, Appellee herein, in the Southern Division of the United States District Court for the Northern District of California, and on the following day he was duly adjudged bankrupt by said court (Transcript of Record, page 5.) On July 22, 1954, John O. England, Appellant herein, the duly elected, qualified and acting trustee of the estate of said bankrupt, filed his Trustee's Report of Exempt Property (T.R., p. 6) with said court, included in which was an exemption on the residence and apartment building located at 940 Potrero Avenue, San Francisco, to the extent of $7,500.00. On

July 29, 1954 there was filed with said court bankrupt's Objections to Trustee's Report of Exempt Property (T.R., p. 7), stating, among other grounds hereinafter described, that the homestead exemption should have been of the valuation of $12,500.00.

There is uncontroverted testimony that on September 1, 1953 when the California Homestead Exemption was increased from $7,500.00 to $12,500.00, the bankrupt was indebted to at least one creditor who has not since been paid (T.R., p. 23.)

On February 26, 1954 the bankrupt executed and recorded the declaration of homestead here in question (T.R., pp. 9 through 11).

Thereafter, after the hearing held on said objections on the 4th day of August, 1954, the Referee made and entered, on the 10th day of February, 1955, his order setting aside to Appellee a homestead exemption not exceeding $12,500.00 (T.R., p. 17), and thereafter Appellant timely filed with the Referee his Petition for Review of said order, and thereafter a hearing was held on said Petition for Review before Hon. Edward P. Murphy, Judge of the United States District Court, and thereafter and on October 5, 1955, Judge Murphy made and entered his order (T.R., p. 66) here appealed from, said notice of appeal having been filed with said District Court on October 24, 1955 (T.R., p. 71).

ARGUMENT.

I. THE DISTRICT COURT IN ITS ORDER OF OCTOBER 5, 1955, ERRED IN SUSTAINING THE ORDER OF THE REFEREE IN BANKRUPTCY DATED FEBRUARY 10, 1955 IN ALLOWING APPELLEE A HOMESTEAD EXEMPTION OF THE VALUE OF $12,500.00, AND IN FINDING THAT SECTION 6 OF THE BANKRUPTCY ACT PREVENTS THE TRUSTEE FROM DENYING A HOMESTEAD EXEMPTION IN EXCESS OF $7,500.00.

Prior to the amendment of Section 1260 of the Civil Code of the State of California in 1953, the bankrupt would have been entitled to a homestead exemption of a valuation of $7,500.00 had he elected to record a declaration of homestead and, prior to said amendment raising the exemption to $12,500.00, the bankrupt was indebted to at least one creditor who is still a creditor in these proceedings. Under Section 70c of the Bankruptcy Act (11 USCA 110c), the so-called "strong arm" clause, the trustee of this estate has, as of the date of bankruptcy, all the rights, remedies and powers of a creditor holding a lien by legal or equitable proceedings upon the said real property. (See *Sampsell v. Straub,* 194 F. 2d 228.) While it is true that the Supreme Court in the case of *Lockwood v. Exchange Bank,* 190 U.S. 294, 47 L. Ed. 1061, held that exempt property does not pass to the bankrupt estate and the title thereto remains in the bankrupt, still, where there is an equity in the property over and above the applicable homestead exemption and all valid liens, the trustee can realize that equity for the benefit of the bankrupt estate. (*Blood v. Munn,* 155 C. 228, 100 P. 694.) In any event, the trustee succeeded to the rights of these prior creditors and under the doctrine of *Moore v. Bay,* 284 U.S. 4,

76 L. Ed. 133, the trustee, by subrogation, can enforce the rights of these prior creditors for the benefit of the bankrupt estate; and the estate is to be distributed among all creditors, irrespective of whether the allowed claims arose prior to the increase of the homestead exemption, or afterwards.

Neither the District Court nor the Referee discuss or distinguish the rights of the trustee under the doctrine of *Moore v. Bay, supra,* and the District Court stated that "the remedy of those creditors whose rights under California law extend beyond the $12,-500.00 exemption is in the State courts" (T.R., p. 67), which subject will be hereinafter discussed.

Both the District Court (T.R., p. 66) and the Referee (T.R., p. 31) refer to the case of *In re Rauer's Collection Co., Inc.,* 87 C.A. 2d 248, 196 P. 2d 803, and dispose of that decision by stating that it does not involve a bankruptcy proceeding, and thus the question of Section 6 of the Bankruptcy Act (11 USCA 24) is not involved.

In the *Rauer* case, the District Court of Appeal of the State of California stated, at page 253, as follows:

> "That the increase in exemption cannot be given a retroactive interpretation, as it would be an impairment of the obligation of contracts, and *that the creditor is entitled to rely upon the exemption statutes as of the time the obligation was incurred, is well established. Medical Finance Assn. v. Wood,* 20 Cal. App. 2d Supp. 749, 63 P. 2d 1219), and *Smith v. Hume,* 29 Cal. App. 2d

Supp. 747 (74 P. 2d 566), dealt with the enactment in 1935 of Section 690.24 of the Code of Civil Procedure, making a motor vehicle of a value less than $100 exempt from execution. No such exemption had theretofore existed. In both cases it was held that to give a retroactive effect to this statute would be in violation of the State and Federal Constitutions, as it would impair the obligation of contracts. (Emphasis added).

In *The Queen,* 93 F. 834, it was held that a California statute exempting from execution seamen's wages not exceeding $100.00 "as applied to previous contracts made with seamen, at a time when no such exemption is allowed, would materially lessen and impair the obligation of such contracts." (P. 837) See also *In re Fox,* 16 F. Supp. 320, and Waples on Homestead and Exemption (1892), pp. 227-229.

" 'It is settled that every statute will be construed to operate prospectively unless the legislative intent to the contrary is clearly expressed. . . . The rule that a statute is presumed to operate prospectively only, unless an intent to the contrary clearly appears, is especially applicable to cases where retroactive operation of the statute would impair the obligations of contracts or interfere with vested rights.' (*Jones v. Union Oil Co.* (1933) 218 Cal. 775, 777, 778 (25 P. 2d 5, 6); to same effect *People v. Allied Architects Assn.* (1927), 201 Cal. 428, 437 (257 P. 511). . . .

"But even if a retroactive intent can be found in the statute, the application of the new exemption to executions issued on pre-existing contracts is prevented by the provisions of the Constitu-

tions of the United States (Art. 1, Sec. 10) and of California (Art. 1, Sec. 16), forbidding laws impairing the obligation of contracts. . . . Statutory provisions creating new, or increasing old, exemptions have been considered several times by the United States Supreme Court, and it has uniformly held that their application to executions based on pre-existing contracts would violate the provisions of the Federal Constitution above referred to. (*Gunn v. Barry,* (1873), 15 Wall. 610 (21 L. Ed. 212); *Edwards v. Kearzey,* (1878), 96 U.S. 595 (24 L. Ed. 793); *Bank of Minden v. Clement,* (1921), 256 U.S. 126 (41 S. Ct. 408, 65 L. Ed. 857); *W. B. Worthen Co. v. Thomas,* (1934), 292 U.S. 426 (54 S. Ct. 816, 78 L. Ed. 1344, 93 A.L.R. 173)" (*Medical Finance Assn. v. Wood,* supra 20 Cal. App. 2d Supp. 749, 750, 751.)

"While it is competent for the legislature to change the form of remedy, if it can do so without impairing the obligation of contract, a statute increasing the exemption of debtors is void to the extent that it is applicable to contracts made prior to its enactment." (12 Cal. Jur., p. 333).

93 American Law Reports, page 178 states that "the now generally accepted view" is that the remedy is inseparable from the contract itself, and contracts not reduced to judgment are held to be substantially impaired by the authorization of a new or increased exemption."

The foregoing citation is a clear statement of the law of exemption rights in the State of California as decided by the highest appellate court of the State which has ruled on the question, and which has never

been overruled by that court or by the Supreme Court of the State of California.

We are aware of no decision on the question here involved by this, and the sole reported decision by a Federal Court in this Circuit involving this exemption question is Judge Yankwich's decision in the case of *In re Fox* (District Court, Southern District of California, Central Division, 1936), 16 F. Supp. 320. In that case, the court considered the exemption statutes of the State of California involving automobiles, increasing same from $100 to $250 in value and except that the instant case involves the homestead exemption provision, it is on all fours with the instant case, and that court held that such exemption provisions are unconstitutional insofar as they apply to debts incurred *before* they went into effect. The court stated at page 321, as follows:

> "It is an accepted constitutional doctrine in the Courts of the United States that statutes establishing an exemption, *or increasing it materially,* are unconstitutional insofar as they apply to debts incurred prior to the establishment or increase of the exemption." (Emphasis added).

The District Court in the order complained of (T.R., p. 67) and the Referee (T.R., p. 28) refer to Section 6 of the Bankruptcy Act (11 USCA 24), which section reads in part as follows:

> "This Act shall not affect the allowance to Bankrupts of the exemptions which are prescribed by the laws of the United States or by State laws in force at the time of the filing of the

> Petition in the state wherein domiciled for six months immediately preceding the filing of the Petition or for a longer portion of such six months than in any other state . . ."

and hold that this section creates a situation where, under the Bankruptcy Act, the Federal Court is not bound by the State Court decision in the *Rauer* case because Section 6 allows exemptions which are "prescribed" by the laws of the United States or by the State laws "in force" at the time of the filing of the petition, and thus, since on April 12, 1954, Section 1260 of the California Code allowed a homestead exemption of $12,500.00, such amount must be allowed to the Appellee Bankrupt. Referee Wyman further stated (T.R., p. 35)

> "Consequently this Bankruptcy Court (if the Rauer Case ruling is to be followed) would have no maximum valuation figures to be used to limit the herein bankrupt's homestead allowance, and hence there would be no 'prescribed' law 'in force', at the time of the filing of the petition in the above entitled bankruptcy proceeding to which this Bankruptcy Court could look to ascertain the maximum homestead valuation that could be allowed to the bankrupt."

If this strained interpretation of the law were to be followed, it would be plain that a bankrupt would be entitled to an exemption of $5,000.00 in excess of a nonbankrupt as to his creditors in existence at the time of the increase of the exemption. Appellant agrees that the exemption "prescribed" and "in

force", at the time of the filing of the original petition in bankruptcy must properly be followed, but contends that the exemption laws "prescribed" and "in force" in the State of California on April 12, 1954 must be determined by examining the particular provisions involved as enacted by the legislative bodies and the interpretation thereof by the courts of competent jurisdiction. Federal courts are bound by state court exemption statutes. *Ralph v. Cox* (CCA 8th Cir.) 1 F. 2d 435. The determination of homestead exemption rights in the federal courts is governed by the statutes and decisions of the states. *First National Bank v. Glass,* 75 Fed 706. *In re Grodzins,* 27 F. Supp. 521, DC, SD, Cal. C.D. In the case of *In re Shepardson,* 28 F. 2d 353, a District Court for the Southern Division of California held that "the right to claim exempt property, and the kind and quantity that is to be allowed to bankrupt debtor, are matters regulated wholly by law of the state within which the proceedings are had and the bankrupt resides." This latter case involved the homestead provisions of the State of California and though not specifically involving the value of such homestead, used the law of the State of California to determine the type of homestead. The same type of ruling involving the interest of a bankrupt in homestead property was by this court determined by reference to the decisions of the appellate court of the State of California in the case of *Russell v. Laugharn,* 20 F. 2d 95. In *Dixon, et al. v. Koplar, et al.,* (CCA 8 Cir.) 102 F. 2d 295, that court again established the principle

> "Thus the rights of a bankrupt to property as exempt are those given to him by the state statutes; and the federal courts, sitting as courts in bankruptcy, will determine exemptions according to those statutes, and *the decisions of the courts of last resort of the states construing and applying those statutes.*",

citing cases. This doctrine of *stare decisis* is ignored by both the Referee and the District Court in spite of the decisions above referred to and the case of *MacKenzie v. United States,* CCA 9, 109 Fed. 2d 540, in which case, involving tax liens, this court clearly applied said doctrine. This court said:

> "The Federal tax lien is entirely statutory, and therefore its scope and effect are to be determined solely by the statute *and the decisions interpreting it.*" (Emphasis ours).

If the long established doctrine of *stare decisis* had been followed by the Referee and/or the District Court, there can be no question but that the law "prescribed" and "in force" on the date of the filing of the original petition would have the Appellee Bankrupt to a homestead exemption not to exceed $7,500.00, and as against creditors in existence at the time of the increase in the exemption statute and under the provisions of Section 70c (11 USCA 110c) of the Bankruptcy Act, and *Moore v. Bay,* supra, hereinabove discussed, Appellant Trustee stands in the shoes of such creditors. By virtue of Section 70c of the Bankruptcy Act, the trustee has all of the rights, remedies and powers of a creditor holding a

lien upon the property of the bankrupt, whether or not such a creditor actually exists. In this connection we call the court's attention to *Sampsell v. Straub,* supra, and the recent decisions by the United States Court of Appeals in *Constance v. Harvey,* 215 F. 2d 571, in which that court held that the Trustee under Section 70c of the Bankruptcy Act was entitled to be in a position of an "ideal" hypothetical creditor whether or not a creditor existed at the time in question. This case was followed in *In re Gondola Associates, Inc.,* 132 F. Supp. 205.

In *Smith v. Hume,* 29 Cal. App. 2d Supp., 747, 74 Pac. 2d 566, cited in *Rauer's Collection Co., Inc.* supra, the court stated, at page 749, as follows:

> "If the question were a new one, we would feel that there were considerable force in the appellant's argument, but the tendency of the Supreme Court of the United States has been to discountenance as violating Article 1, Section 10 of the Federal Constitution, *any extension of an exemption statute, substantially affecting the right of a pre-existing creditor to obtain satisfaction of his debt."* (Emphasis added).

The ruling sought by the trustee in these proceedings is not only in accordance with the cases above cited, but also is in accord with the recent decision of Hon. Reuben G. Hunt, Referee in Bankruptcy of the United States District Court for the Southern District of California, *In the Matter of Zarmond Goodman,* bankrupt, No. 61202-HW in the records and files of that court, wherein Referee Hunt ruled

on December 23, 1954 that increases in the very same homestead exemption were invalid in regard to then existing creditors. On the identical facts as presented in this case, Hon. Evan J. Hughes, Referee in Bankruptcy of the United States District Court for the Northern District of California, also held the increase in homestead exemption invalid as to then existing creditors *In the Matters of Frank Towers* and *Melvin Towers,* Docket Nos. 13581 and 13583, respectively, in the files and records of the Northern Division of said District Court.

There does not appear to be any valid distinction in the fact that the homestead was filed after the effective date of the amendment raising the exemption any more than there would be any distinction in the cases increasing the value of the automobile exemption to $250.00 if the automobile were acquired after the effective date of the raise in the exemption. This principle is best illustrated by the case of *The Queen,* (USDC, NDC) 93 Fed. 834, where the court held that a California statute exempting from execution seamen's wages not exceeding $100.00 would have no effect as to contracts made *prior* to the time when the exemption was created. The obligation in this case was incurred *before* the statute increasing the exemption was enacted. However, in *The Queen,* the wages were earned *after* the statute became effective. *The Queen,* supra, clearly showed that it was not the effective date of the statute that is important, but *the date when the obligations were incurred,* as the vital point

is the impairment of the obligations, not the effective date of the statute.

> "That the exemption statutes are to be given liberal construction is a well accepted principle of law with which the Appellant does not quarrel, but such liberal construction does not mean that the courts may enlarge the exemption or read into the exemption laws provisions not found there. The construction given to the statutes must be consistent with a true and just interpretation of their terms in view of the purposes for which they were enacted. Here, as in other cases of statutory construction, the court will not expand the meaning of the words or phrases appearing in the acts or indulge in so-called 'judicial legislation'. It is not for the court, by dictum or decision, to create a right of exemption where none is found in the statute or to say that the legislature intended a larger grant of exemption than is given by the plain wording of the statute."
>
> 22 *Am. Jur.* 10.

II. THE DISTRICT COURT IN SAID ORDER OF OCTOBER 5, 1955 ERRED IN FINDING THAT THE REMEDY OF THOSE CREDITORS WHOSE RIGHTS UNDER CALIFORNIA LAW EXTEND BEYOND THE $12,500.00 EXEMPTION IS IN THE STATE COURTS.

The District Court in its order appealed from stated that the remedy of those creditors whose rights

under California law extend beyond the $12,500.00 exemption is in the State Courts. (T.R., p. 67)

In support of this position, the District Court cited *In re Buckley* (District Court, Western District of Louisiana), 24 F. Supp. 832 on the theory that the prior lien creditors must seek their remedy in the state court and also that the title to exempt property under state law does not pass to the trustee in bankruptcy. However, the *Buckley* case clearly holds that where the fair value of the property exceeds the exemption, the Trustee may sell the property, and in this connection, see also *Blood v. Munn,* supra. In the case before the court, there are no lien creditors who could asset any rights in the state courts and thus any general creditor seeking to do so would be faced with an answer setting up the discharge of the obligation in these bankruptcy proceedings. In any event, the Trustee under the doctrine of *Moore v. Bay,* supra, succeeded to the rights of the prior creditors, and the only way that the prior creditors can be protected by law "prescribed" and "in force" is by their representation by the appellant Trustee in Bankruptcy under the provisions of Section 70c of the Bankruptcy Act hereinabove discussed.

In view of the facts and law hereinabove set forth, it is Appellant's contention that the statute passed by Legislature of the State of California increasing the homestead exemption from $7,500.00 to $12,500.00 is inoperative as against those creditors of the bankrupt Appellee who extended credit prior to the date

of its enactment, and thus that the bankrupt Appellee is entitled to a homestead exemption not to exceed the sum of $7,500.00 in actual cash.

Dated, San Francisco, California,
March 5, 1956.

Respectfully submitted,
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